Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of

CONNECT AMERICA FUND	)	WC Docket No. 10-90
	)	
A NATIONAL BROADBAND PLAN FOR OUR FUTURE	))	GN Docket No. 09-51
	)	
ESTABLISHING JUST AND REASONABLE RATES FOR LOCAL EXCHANGE CARRIERS	)))	WC Docket No. 07-135
	)	
HIGH-COST UNIVERSAL SERVICE SUPPORT	))	WC Docket No. 05-337
	)	
DEVELOPING AN UNIFIED INTERCARRIER COMPENSATION REGIME	)))	CC Docket No. 01-92
	)	
FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE	)	CC Docket No. 96-45
LIFELINE AND LINK-UP		WC Docket No. 03-109

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COMMENTS OF FAIRPOINT COMMUNICATIONS, INC.
WC DOCKET 10-90 *ET ALIA*

EXECUTIVE SUMMARY

FairPoint serves rural customers in 32 study areas in 18 states; three study areas are deemed non-rural, and 29 others are deemed rural, under a combination of price cap and rate-of-return regulation. The revenues that FairPoint has received under the federal high-cost universal service mechanism and inter-carrier compensation programs have been essential to FairPoint's ability to offer nearly ubiquitous infrastructure in its service territories, supporting both basic telecommunications and advanced services. In fact, broadband is available to 92 percent of the access lines in FairPoint's legacy rural service areas. FairPoint agrees that the current high-cost programs will not provide adequate revenue to assure that broadband will be extended to all Americans. FairPoint acknowledges that they have some inefficient aspects; however, they should be cautiously reformed, not replaced wholesale. The Commission must provide support that is "specific, predictable, and sufficient" for rural carriers of last resort ("COLRs") such as FairPoint to continue providing access to comparable services, including advanced services, at reasonably comparable and affordable rates.

With respect to the HCLS, ICLS and LSS funding mechanisms relied upon by rural rate-of-return carriers, FairPoint opposes the NPRM's proposed near-term changes as unlikely to achieve the desired efficiency increases. Rule changes must be made in a manner that preserves needed revenue streams in very high-cost areas. FairPoint supports reasonable limits on carriers' interstate recovery of corporate operating expense. FairPoint agrees that employing a regression formula may be appropriate, provided that the calculation is done before separations, and applied to unseparated, regulated costs. Alternatively, FairPoint suggests that the FCC apply the HCLS corporate operations expense cap to the calculation of LSS and ICLS.

With respect to IAS funding relied upon by price cap carriers, FairPoint opposes the proposed "transition" which really is a phasing out of this support altogether. This proposed reform will not reduce the interstate revenue requirement of incumbent local exchange carriers ("ILECs"), but only shift the burden of recovery from a wider base of telecommunications service customers to the narrower, and continually narrowing, base of subscribers in the affected ILECs' increasingly competitive markets.

Finally, the new Connect America Fund ("CAF") should be adequately sized to fund broadband build-out at affordable rates. It should be prioritized such that funding is first made available in the areas that are the most expensive to serve. It should not be limited in the first phase to providers in states that have lower intrastate access rates or higher local rates. Receipt of CAF support should be tied to COLR obligations. ILECs should have a right of first refusal since they almost always are obligated to serve as COLR under applicable state law.

The Commission should evaluate the effect of its near-term reforms before deciding whether any additional changes to the remaining high-cost support mechanisms and inter-carrier compensation policies are necessary and in the public interest.

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COMMENTS OF FAIRPOINT COMMUNICATIONS, INC.

FairPoint Communications, Inc., on behalf of its operating subsidiaries ("FairPoint"), hereby responds to the Commission's recent NPRM in the above-captioned proceedings.[1]

[1] *Connect America Fund*, WC Docket Nos. 10-90, *et al.*, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 11-13 (rel. Feb. 9, 2011) (the "*NPRM*"), 76 Fed. Reg. 11632 (Mar. 2, 2011). In accordance with the comment deadlines established by the Commission, FairPoint submits these comments on the portions of the NPRM other than Section XV.

I. INTRODUCTION & THE ROLE OF INTER-CARRIER COMPENSATION

The Commission is bound by statute to ensure that all Americans have access to rapid, efficient and high-quality communications services with adequate facilities at affordable rates.[2] FairPoint provides "carrier of last resort" ("COLR") service in 32 study areas in 18 states.[3] As such, it is FairPoint's duty to provide advanced telecommunications services at affordable rates and maintain full-service networks for the benefit of retail and wholesale customers throughout its statutory service areas, including in areas where there is no business case to do so in the absence of access revenues and universal service support.

In Section III of the NPRM, the Commission acknowledges that federal universal service programs have worked in tandem with inter-carrier compensation ("ICC") (and access charges in particular) to allow incumbent local exchange carriers ("ILECs") to provide basic telecommunications services to all customers in their service areas at affordable rates and, in the case of some carriers, to upgrade their networks to provide advanced telecommunications and information services.[4] FairPoint concurs with this assessment. FairPoint has made substantial

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[2] *See* 47 U.S.C. §151 (creating the FCC for the purpose of regulating interstate and foreign communication to make available to all people of the United States "a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges"); §254(b)(1) ("Quality services should be available at just, reasonable, and affordable rates"); *see also* TELECOMMUNICATIONS ACT OF 1996 §706(c)(1) (defining "advanced telecommunications capability" as enabling users "to originate and receive high-quality voice, data, graphics, and video telecommunications using any technology").

[3] As noted in the NPRM, while COLR obligations vary in their particulars from state to state, COLR obligations typically include the duty to provide service to all customers in a defined geographic area, to extend lines upon request, to meet service quality and other performance requirements, to submit to rate and/or earnings regulation, and to continue serving the public until the state grants permission to exit the market. *See* NPRM para. 91 & n. 157.

[4] *E.g.,* NPRM paras. 45, 52.

investments in infrastructure to bring rapid and efficient communications services, including broadband services, to its customers.[5]

The Commission further points out that different ILECs have fared very differently under the current rules. In particular, companies operating in study areas deemed "non-rural" have been allocated support based on a forward-looking cost proxy model, while rural carriers have been permitted to recover a substantial portion of their historic or actual costs through the universal service programs. Similarly, price cap ILECs have recovered a portion of their interstate costs through the interstate access support ("IAS") fund while ILECs that have remained under rate-of-return regulation have recovered similar costs through the interstate common line support ("ICLS") fund.[6] The NPRM states that many Americans – as many as one in thirteen – live in areas without access to broadband communications capability, and suggests that the mechanisms in place to ensure universal service at affordable rates have been inadequate or inefficient in promoting universal broadband deployment.[7]

FairPoint believes the Commission should give credit where it is due. The Commission should continue programs that have effectively promoted universal service, and only modify those mechanisms that have not been as effective. Rather than scrap the federal universal service regime and inter-carrier compensation mechanisms as inefficient and inadequate, FairPoint urges the Commission to take a more measured approach. The revenues that FairPoint receives today under these policies are essential to ensure current levels of service, including

5 In 2010, FairPoint invested $197.8 million, approximately 18.5% of its revenue, in telecommunications infrastructure.

6 *See* NPRM paras. 52, 54.

7 NPRM paras. 5-8.

infrastructure that supports basic telecommunications as well as advanced services available in 92 percent of the access lines in FairPoint's legacy rural service areas.[8]

FairPoint is concerned that many of the proposals set forth in the NPRM will result in substantial reduction in inter-carrier compensation and universal service revenues, which are necessary in part to ensure FairPoint's transition to an all-IP network – the Commission's purported goal[9] – and extend broadband services to the remaining unserved areas within FairPoint's operating territory. Further, the absence of sufficient revenues will jeopardize FairPoint's ability to fulfill its COLR responsibilities, maintain and upgrade the existing infrastructure, and offer increasingly advanced and higher-bandwidth capabilities.[10]

It is therefore essential that the Commission establish federal revenue recovery mechanisms to offset any reductions in ILEC access rates, consistent with the goals of the NPRM and the Communications Act's universal service mandate.[11] Particularly in light of the expectation, articulated in the NPRM and the National Broadband Plan ("NBP"), that network operators will significantly expand their infrastructure and service capabilities, it is not reasonable to expect rural service providers such as FairPoint to continue providing access to

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8 FairPoint's legacy rural service areas are those where FairPoint operated as a local exchange carrier prior to the company's acquisition of landlines from Verizon New England Inc. in Maine, New Hampshire, and Vermont on March 31, 2008.

9 NPRM para. 6 (describing the transition from circuit-switched networks to Internet protocol ("IP")-based networks as essential for the country's global competitiveness); NPRM para. 14 (describing the goal of the NPRM as "modernizing and refocusing USF and ICC to ensure all Americans have access to robust, affordable broadband and to accelerate the transition to IP networks").

10 It bears mentioning that ILECs such as FairPoint recover a portion of their capital expenditures from federal high-cost support several years after it has been spent, under the present rules (unlike a CETC, which receives support at the same per-line level as the ILEC, based on the CETC's *current* line counts, highlighting further the disparity in how support is provided). Thus FairPoint's capital investment going back several years was made in contemplation of these streams of revenue today and in the future.

11 47 U.S.C. §254(b).

reasonably comparable services, including advanced services, at reasonably comparable rates, in the high-cost areas often found in the rural areas served by both rural and non-rural ILECs, absent a sufficient revenue recovery mechanism.

II. The Path To Reform: Eligible Telecommunications Carriers ("ETCs") Should Bear An Obligation to Provide High-Quality (Voice and Broadband) Communications At Affordable, Reasonably Comparable Rates, as Carriers-of-Last-Resort Do Today

The Commission appears ambivalent as to whether voice communications should remain a "supported service" or merely an application available over broadband transport service, accessible via an Internet access provider.

On the one hand, the Commission proposes in Section V of the NPRM that all ETCs be required to provide "voice telephony service" throughout their designated service areas, either on a facilities basis or by reselling the services of another provider.[12] As the NPRM acknowledges, the Communications Act requires that federal universal service programs "preserve and advance voice service" to customers in high-cost areas.[13]

On the other hand, the Commission appears to have decided that its policies no longer should support networks that are designed to deliver high-quality voice communications – *i.e.,* circuit-switched telecommunications networks[14] – but instead should encourage investment only in IP-based networks.[15] Apparently, the Commission has decided that, in the future, American

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[12] NPRM para. 98. The NPRM even proposes that voice service continue to be mandated as a stand-alone service, for any customer requesting it. NPRM para. 99.

[13] NPRM para. 80 (citing Section 254 of the Act).

[14] *See, e.g.,* NPRM para. 6 (calling circuit-switched infrastructure "outdated").

[15] *E.g.,* NPRM para. 14.

consumers should obtain voice telecommunications services as "one of many applications" running over IP-based networks.[16]

Rather than predetermining a technology path, FairPoint urges the Commission to allow market demand and American entrepreneurial drive to lead the way to technology transformations. If twelve out of thirteen Americans have access to broadband to the home barely fifteen years from the commercial introduction of dial-up Internet access services, this astounding accomplishment is due not to government mandates or massive public works projects but to market-driven ingenuity and entrepreneurship. It is the knowledge, skill, motivation and dedication of the U.S. industry – beginning with the telecommunications carriers – that spurred this remarkable accomplishment, so much so that "[u]biquitous broadband infrastructure has become crucial to our nation's economic development and civic life."[17]

FairPoint respectfully submits that the NPRM is ambiguous about requiring that ETCs have the capability to support voice as a stand-alone service yet not requiring that ETCs submit to state or federal regulations applicable to voice service, including service availability, quality, reliability, and affordability. Service must be reasonably comparable and affordable to satisfy the statutory requirements for universal service. FairPoint therefore believes that, in order to ensure truly universal service, only entities designated as COLRs should qualify for ETC designation.[18]

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16 NPRM para. 10.

17 NPRM para. 3.

18 FairPoint has conducted market surveys that confirm that it maintains high market share in high-cost areas, in some places over 90%, whereas in low-cost areas, FairPoint has as little as 15% of the combined residential and business market for wireline voice and data services. Market share disparities also exist between high-margin customers (retail business customers) and low-margin (residential and wholesale) customers. It should come as no surprise that competitors are drawn to compete for customers in the lowest-cost areas where they can maximize profits, but the Commission's ETC requirements should reflect this reality.

Further, FairPoint urges the Commission to be clear about its intentions to preempt state regulation. If the Commission intends to define new national standards for voice as well as broadband services, as the NPRM suggests,[19] clarification is needed as to the extent to which the Commission will preempt inconsistent state regulations, or state requirements that simply cannot be fulfilled because of the reduction in federal revenue streams.

A case in point is the Tribune exchange in Kansas, which covers the county of Greeley. This service area covers 900 square miles where FairPoint's local ILEC provides telecommunications services to 757 customers as their COLR. Of these, 573 customers are located in the town of Tribune, about one square mile in area, and the remaining 184 customers are scattered across the remaining 899 square miles of the service area. Not surprising, the 573 customers in town have access to competitive alternatives, including cable and wireless service providers, which have no COLR obligations. Also not surprising, the 184 customers scattered across the remaining 899 square miles have no effective competitive alternative for voice or broadband service – even commercial mobile radio service ("CMRS") coverage is spotty. As FairPoint loses customers in the town limits to wireless and cable competitors, its overall costs to serve the 900 square-mile area do not decline in any meaningful sense. FairPoint simply is expected to "do more with less." As long as FairPoint retains the obligation under Kansas law to serve as COLR to the 184 high-cost customers, the only reasonable business case includes some form of revenues from ICC and high-cost support.[20]

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[19] *E.g.,* NPRM para. 92.

[20] By way of comparison, at 900 square miles, the Tribune exchange is more than 13 times the size of the District of Columbia, at 68.3 square miles. Across 899 square miles of the Tribune exchange, there are only 184 customers – the equivalent would be serving a mere 14 customers in D.C.'s 68 square miles. FairPoint is the only provider of voice and broadband services to these customers. FairPoint built and must maintain the facilities over this large expanse of country to ensure that consumers there remain connected.

The Commission should bear in mind, as it considers changes to its ETC designation rules as well as revisions to ICC and federal support mechanisms, that the difference in the cost of serving particular customers is far and away the most important factor driving variations in infrastructure deployment. How attractive an area may be to competitors merely provides concrete evidence of the cost differences that are well known to the COLR. Before the FCC takes action that could undermine the high-quality and reliable national telecommunications infrastructure in the name of increasing efficiency and stimulating competitive deployment of "modern" technologies, it should develop a clear understanding of the risks of changing the way telecommunications infrastructure is funded, and the likelihood that any entity would volunteer to serve as a LEC if that means COLR responsibilities without the assurance of appropriate funding.

III. NEAR-TERM REFORMS SHOULD NOT WORK AGAINST BROADBAND BUILD-OUT INCENTIVES

A. Proposed Changes to HCLS, ICLS and LSS for Rate-of-Return Carriers May Improve Efficiency Incentives Somewhat, But Likely Will Produce Only Negligible Reduction In Total Universal Service Support

The Commission states that it intends to "transform" the existing high-cost universal service support mechanisms and certain other common line cost recovery mechanisms (notably IAS and ICLS) into a new "Connect America Fund" ("CAF"). As a preliminary step, the Commission proposes in Section VI of the NPRM to "eliminate waste and inefficiency" in several funding mechanisms that apply to rate-of-return carriers, and set these carriers "on the path to incentive-based regulation."[21] The Commission indicates that these near-term reforms would commence in 2012, but could be phased in over a few years.[22]

FairPoint disagrees with the premise that eliminating local switching support ("LSS") and curtailing high-cost loop support ("HCLS") will "ensure incentives for rate-of-return carriers to invest in and operate modern networks capable of delivering broadband as well as voice services."[23] Moreover, while FairPoint agrees that adjustments can be made to improve carrier efficiency incentives, FairPoint disagrees that the proposed changes will meaningfully decrease "excessive spending" or reduce federal support obligations.[24]

The proposal to simply eliminate LSS cannot be accomplished without leaving rural rate-of-return ILECs with a funding gap. Part 36 assigns certain local switching costs to the interstate jurisdiction for rural carriers with fewer than 50,000 lines in a study area. This is accomplished through a weighting factor, for Dial Equipment Minutes ("DEM") traffic. By allocating a higher percentage of switching costs to the interstate jurisdiction, the separations process assigns additional amounts of depreciation reserves, depreciation expense, maintenance expense, and higher amounts of associated other plant expense and corporate operations expense. The costs thus assigned to the interstate jurisdiction above the unweighted DEM factor are recovered through LSS. If the Commission eliminates LSS, it will leave recipients with no opportunity to recover the costs. A carrier could attempt to raise local end-user rates, but with the costs assigned to the interstate jurisdiction, the states will not likely allow recovery.

If the FCC were to allow continued recovery of the excess switching costs by combining LSS with HCLS, it is difficult to see what would be gained. The Commission believes it would

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21 NPRM para. 157.
22 NPRM para. 158.
23 NPRM para. 158.
24 NPRM para. 158.

discourage maintenance of separate study areas within a state,[25] but many factors weigh into a carrier's decision to seek authority to merge study areas, not least of which are the cost differences that underlay pricing differences. In short, the Commission's proposal seems contrary to established principles of cost-based pricing and the elimination of implicit subsidies.

Reducing permitted revenue recovery through HCLS similarly may fail to have the desired effect. HCLS allows recovery of a portion of an ILEC's loop costs where the carrier's study area cost per loop ("SACPL") exceeds the national average cost per loop ("NACPL") by a significant amount. Under the Commission's rules, reducing the costs that may be recovered through HCLS will have the effect of shifting those unrecovered loop costs to end-users through intrastate charges. Such a shift would threaten the affordability of end-user rates, and violate the Communications Act's requirement that support be "sufficient" to ensure that rates in high-cost areas are affordable and reasonably comparable to those in other areas.[26]

FairPoint has seen significant year-over-year drops in its HCLS. This is due to several factors, including reductions in net rate base, and reductions in FairPoint's operating expenses, but increases in the NACPL have played a significant role as well. FairPoint agrees that allowing some carriers to recover 100% of their SACPL in excess of 150% of the NACPL may not provide adequate incentives to those carriers to control their costs. Once a rural carrier has achieved this spending level in a particular study area, the more it spends on plant, the more it may recover, targeting the authorized interstate rate-of-return of 11.25%, further driving up the NACPL. FairPoint proposes that a better way to address this perverse incentive would be a modification in the HCLS formula such that no carrier may recover 100% of its common line

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[25] NPRM paras. 191-192.

[26] 47 U.S.C. §254(b)(1), (3).

costs from the interstate jurisdiction. Since HCLS operates as an expense adjustment, no change to jurisdictional separations would be required to put this change into effect.

FairPoint also agrees that the Commission has a legitimate interest in ensuring that the allowable percentage of corporate operations expense is set at a reasonable level.[27] FairPoint would point out, however, that corporate operations expense is a necessary part of operating a network. It represents costs that are required in any business, including senior management that directs the company's operations, finance that raises capital on which the business runs, as well as human resources, regulatory compliance, labor relations, IT operations, risk management, strategic planning and other essential management functions. The costs are used and useful in the operation of regulated companies, and there is a 100-year history of allowing such costs in revenue requirements for telephone companies.

The FCC proposes to eliminate corporate operations expense recovery from ICLS and LSS. This would require a separations change to shift these costs to the intrastate jurisdiction since Part 36 assigns these costs to the interstate jurisdiction. Absent a separations change, the FCC cannot simply throw out used and useful costs, offering the carriers no opportunity for recovery. Ultimately, handing these costs to the states resolves nothing either – the FCC would simply be moving the burden to the state commissions to increase intrastate rates in order to recover the shifted costs.

FairPoint supports reasonable reforms to address abuses, but reforms need to be made in a manner that preserves needed revenue streams in areas that are very expensive to serve. FairPoint supports the Commission's proposal to permit carriers that serve very high-cost

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[27] *See* NPRM para. 197.

carriers to receive HCLS and ICLS at levels they need to provide services in high-cost areas. [28] The FCC may limit carriers' interstate recovery of corporate operating expense to a reasonable amount. The FCC proposes to use a regression formula to cap operating expenses. FairPoint agrees that this type of approach may be in the public interest, provided that the calculation is done before separations, and applied to unseparated, regulated costs. Alternatively, FairPoint suggests that the FCC apply the HCLS corporate operations expense cap to the calculation of LSS and ICLS. This would be simpler to administer and could be implemented more quickly.

The application of a cap on the rate-of-return carriers' capital investment rate base is far more problematic.[29] ILECs typically have some ability to control yearly operating expenses, but once money is invested on capitalized items, the amount of annual capital costs cannot be reduced. Capital costs represent long-term investment in infrastructure -- what the NPRM seeks to promote – and the ILEC needs to recover that investment or suffer a "taking" of its property without just compensation. If the Commission decides to restrict support for capital expenditures, it should only do so as to prospective investments.

B. "Transitioning" Price Cap Carriers' IAS to CAF Should Yield Specific, Predictable and Sufficient Support, Not Simply Shift Costs To End-Users

In Section VI.C of the NPRM, the Commission proposes to "transition" amounts of support currently recovered by price cap carriers through IAS over a period of a few years.[30]

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[28] NPRM par. 206.

[29] NPRM paras. 201-207.

[30] NPRM paras. 228 *et seq.*

The proposal really is to eliminate the IAS.[31] Current IAS recipients may or may not qualify for any CAF support the FCC ultimately makes available.[32]

FairPoint understands that IAS was implemented as a transitional mechanism designed to be reviewed after five years. However, the fact that the intended transition period has been longer doesn't justify simply eliminating the program without more than a cursory review. The Commission should recognize that this support is needed today as much as ever.

FairPoint fears death by a thousand cuts. Just emerging from Chapter 11, operating primarily in high-cost areas, and facing robust competition in its markets, FairPoint already has plenty of challenges. Whether or not the loss of IAS by itself would cause substantial hardship to FairPoint, when combined with the loss of LSS, reductions in HCLS and ICLS, and especially the loss of interstate and intrastate switched access revenue, it is more than likely that substantial harm will be done.

The NPRM proposes to phase out IAS and reduce other sources of revenues to ILECs like FairPoint, at a time when FairPoint faces other substantial threats to its market share and revenue base. For example, FairPoint is aware of recent federal government awards valued at over $300 million within FairPoint's ILEC service areas, which have been awarded to competitors in order to overbuild FairPoint fiber networks and compete with FairPoint for the broadband business of anchor institutions and other large customers. None of the affected states has proposed lessening FairPoint's COLR obligations, none has considered whether any of these subsidized competitors should themselves have COLR obligations, nor has any examined

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31 *See, e.g.,* NPRM para. 21, p. 12 ("We propose to phase out Interstate Access Support (IAS) over a period of a few years"); para. 233 ("IAS does not appear necessary to provide voice service at affordable and reasonably comparable rates and does not appear to be effectively structured to promote broadband deployment").

32 *See* NPRM para. 238.

whether the loss of lines (and support) by FairPoint will have a negative impact on the public interest.

In short, FairPoint is facing a number of potential *disincentives* to increased investment in infrastructure, FairPoint urges the Commission to carefully consider the effect of any and all revenue-impacting policy changes on rural carriers such as FairPoint. Without continued federal support, who will provide high-quality, reliable and affordable service to customers like those 184 customers in the 899 square miles of Tribune, Kansas?[33]

Moreover, FairPoint does not believe that the proposed IAS cuts would have the desired effect of lowering interstate revenue requirements. Under the FCC's rules, the loss of IAS will simply shift cost recovery to the end-user. Carriers like FairPoint whose current federal subscriber line charge ("SLC") rates are below the cap (FairPoint's residential primary line SLC rate currently is $6.16) will adjust their SLC rates upward, within the limit imposed by the SLC caps. Thus, the direct impact will be to increase FairPoint's *end-user* rates, making the company even more vulnerable to competitive line loss.[34] There is no solution to this dilemma between raising end-user rates and simply taking a loss, other than reduced network investment.

Rather than force price cap carriers to choose between accelerated line loss due to increased end-user rates, and loss of the IAS revenue altogether, the Commission should conduct a needs analysis and, where justified, replace IAS with CAF support. Only if it conducts a reasoned and fact-based analysis can the FCC be certain that it is ensuring that support will be "specific, predictable and sufficient" for the future infrastructure expansion to 100 Mbps that the Commission envisions.

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[33] *See supra* note 20 and accompanying text.

[34] FairPoint estimates that its SLC rates would increase by about $.25 per line per month because of the phase-out of IAS.

For certain carriers, continued IAS revenue will be necessary to avoid undermining the ILEC's ability to maintain current operations and earn a reasonable return on investment, let alone convert their networks to meet future needs. Ultimately, the Commission's goals should include not just reducing the amount of support paid at the federal level but also ensuring that established providers, with proven track records as COLRs, retain the ability to attract the substantial capital that will be needed to fund future infrastructure investment.

C. Phase I of the CAF Should Ensure Adequate Revenue For COLRs

FairPoint supports the proposal to make available "fast track" funding to supplement existing high-cost support, to enable new broadband construction in unserved areas.[35] FairPoint agrees that such funding initially should target areas "that lack even basic broadband today" although FairPoint is not convinced that the National Broadband Map and FCC Form 477 adequately identify such areas.[36] In response to the question "whether additional investments in universal service may be needed to accelerate deployment,"[37] FairPoint says, clearly, yes. The Commission should use Phase I CAF support to enable COLRs serving the highest-cost and hardest-to-reach customers to gain access to broadband capability that is affordable and reasonably comparable to that which is available in lower-cost areas. The support should be incremental to, and not repurposed from, IAS and other support that is employed to maintain the current networks of COLRs such as FairPoint.

1. Fast-Track Funding Is Needed In the Next 12 Months So Unserved Customers May Join the Digital Age

FairPoint agrees that the Commission should take action in the near term to provide funding for targeted investment in robust broadband infrastructure in areas of the country that

35 NPRM para. 261.
36 NPRM para. 261.
37 NPRM para. 275.

lack broadband access today, as a supplement to current support mechanisms.[38] FairPoint disagrees that a limited amount of support should be allotted through an auction "such that not all bids would be successful."[39]

The Commission appropriately proposes to target this first phase of funding at broadband build-out to households and areas that are "unlikely to be served soon or at all without public investment."[40] As the Commission has acknowledged, unserved households are found in every state in the country. Just in the past three years, FairPoint has increased broadband addressability from approximately 68% to over 83%, on average, in its non-rural ILEC service areas in each of the three Northern New England states. FairPoint has made additional broadband build-out commitments in Maine (87%) and New Hampshire (95%). The remaining unserved areas are expected to be the most expensive to reach. New funding therefore is needed to ensure universal broadband coverage.

The Commission's proposal for the Phase I CAF appears to be aimed at bringing some minimal level of "broadband connectivity" to as many unserved individual housing units as possible using the least amount of support possible, by making states and localities compete with one another for this limited support.[41] This may have political appeal, but it is contrary to principles of economic efficiency. Instead, the Commission should target the earliest available funding at those areas that currently are hardest to serve, even with current levels of funding intact. In this way, the Commission could promote availability and adoption of broadband where the market is least likely to do so, rather than devoting scarce resources to areas where the market is more likely to provide a solution.

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[38] NPRM para. 261

[39] NPRM para. 280.

[40] *See* NPRM para. 267.

[41] NPRM para. 276.

Moreover, the Commission should not adopt a subpar broadband standard such as 768 kbps for areas that have no access to broadband today, while promoting higher-capacity broadband deployment in more robustly served areas. This would only perpetuate the "rural-rural divide."[42] The areas that have no access to broadband have been left out too long from the economic, medical, educational, political, cultural and social benefits of broadband connectivity. They arguably have a need for higher connectivity than their counterparts in areas that have long enjoyed connectivity at 1.5 Mbps.[43] If the Commission fails to devote long-denied support to serving these areas, the social cost will be even higher.

2. CAF Should Be Tied to COLR Obligations

The Commission proposes to limit Phase I CAF to one provider in any geographic area.[44] FairPoint agrees, but rather than require states to compete for a limited amount of funding, the Commission should limit eligibility for new CAF support to the COLR for that area.[45]

There is one COLR in any given area – usually it is the ILEC, but not always. Awarding Phase I support to the entity tasked by the state as the COLR will simplify the process of selecting recipients – these entities by and large already have ETC status, and are accountable to the state as well as the FCC to serve all customers on request. Allotting limited Phase I support to the current COLR also will accelerate deployment of much-needed broadband infrastructure,

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42 NPRM para. 6.

43 Today, 1.5 Mbps is a minimum standard for broadband in most areas, and soon 4 Mbps or even 10 Mbps will be expected.

44 NPRM para. 268.

45 FairPoint therefore opposes permitting entities to bid for CAF support before they have been designated as ETCs. NPRM para. 319.

by ensuring the recipient of the support is capable of network construction, maintenance and operation.[46]

FairPoint opposes the suggestion that the Commission limit eligibility for Phase I CAF support to "states that have engaged in access charge reform and/or prioritize support to states that have established high-cost universal service or other broadband support mechanisms."[47] FairPoint believes that such a strategy only will serve to *widen* the "rural-rural divide" that the Commission seeks to bridge.[48] States that have established universal service programs to keep local rates affordable are more likely than others to be already supporting local infrastructure needs. The Phase I CAF should be directed to areas where local needs are going unmet, by focusing entirely on unserved areas. If support is directed to the COLR in areas that have no broadband today, it will make an immediate impact on Americans who have been left out of the digital revolution until now, serving the comparability and affordability goals of the Communications Act.

FairPoint notes with interest that Phase I CAF may be offered to support a second provider in a market,[49] unlike the proposed long-term CAF which the Commission suggests would be allotted "all or nothing" to a single provider in a market.[50] The Commission states that the use of a "market-driven" process to award Phase I CAF support "will spur high-impact

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46 The Commission should not permit inexperienced companies or entities without prior ETC status to bid at auction for CAF. In the early build-out stages under the American Recovery and Reinvestment Act ("ARRA") awards, some recipients already are unable to fulfill the terms of their bids, and are attempting to renegotiate the terms of their ARRA grants.

47 NPRM para. 270.

48 NPRM para. 6.

49 NPRM para. 25 ("If the auction winner is not the existing incumbent recipient of USF in the area during this interim transition period, that incumbent carrier of last resort would continue to receive its existing support, subject to the other reforms proposed in this Notice").

50 NPRM para. 403 (proposing to fund "at most one" provider in each high-cost area, but also seeking comment on funding one fixed service provider and one mobile service provider per high-cost area).

broadband deployment."[51] FairPoint questions why the Commission believes that supporting competing broadband providers is expected to produce such dramatic benefits in Phase I of the CAF, but not in Phase II. In the National Broadband Plan, the Commission concluded that in some areas, installing and maintaining broadband infrastructure is too much of a challenge even for a single provider; that is why there are "unserved" areas today. Therefore, the NBP recommended that a single provider be given support to reach unserved customers in any particular area.[52]

The Commission is not asking COLRs to deliver broadband to areas they cannot afford to serve today based on current levels of support, but rather is proposing making additional support available in the short-term, in the form of Phase I CAF, to support infrastructure expansion.[53] Why then would the Commission expect that the same COLR would have the ability to deploy broadband infrastructure without such supplemental support, and in competition with another provider that *is* receiving a subsidy? The suggestion defies sound economic principles.

IV. LONG-TERM REFORMS SHOULD PROVIDE ADEQUATE INVESTMENT INCENTIVES

FairPoint supports the Commission's long-term goal of transitioning all high-cost support to a single program, the CAF. Because the Commission's proposals for this transition are more tentative, and because it makes sense to postpone some final decisions until the Phase I CAF is in place, FairPoint provides these limited comments on Section VII. of the NPRM.

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[51] NPRM para. 25.

[52] Federal Communications Commission, *Connecting America: The National Broadband Plan* (rel. March 16, 2010).

[53] *See, e.g.,* NPRM para. 25 ("If the auction winner is the existing provider, the new funding would supplement its existing support…").

A. The COLR or ILEC Should Have CAF Right of First Refusal To Receive Specific, Predictable and Sufficient Support

FairPoint supports the Commission's proposal to offer the COLR, which typically will be the ILEC, a right of first refusal ("ROFR") to receive CAF to extend broadband service to unserved households in its service territory.[54] As discussed above, the ILEC typically is already designated by the state as an ETC and almost always has COLR responsibilities to provide high-quality, reliable voice telecommunications service to all customers within a specified geographic area upon request. This carrier is accustomed to meeting legal obligations to serve all at rates deemed affordable. The ROFR makes sense, provided the support levels are set at amounts designed to ensure reasonable cost recovery.

The Commission seeks comment on several alternatives for determining the size of the CAF and the allotment of support to any given geographic area. Under the proposed ROFR, the Commission would develop a model to determine how much CAF to offer the current COLR, comparing the predicted cost to serve the COLR's service area to a national cost benchmark.[55] So far, so good. How the model would predict the cost of serving any particular area is the critical piece of missing information.

Several alternatives for developing a cost-predictive model are suggested in the NPRM. For example, the model could estimate the forward-looking costs of providing broadband and voice service over a wireline network, or over the least expensive technology available.[56] The inputs would be critical to ensuring the results predicted by the model would produce adequate levels of support.[57] While many details remain to be worked out, FairPoint supports the apparent

54 NPRM para. 400.
55 NPRM para. 432.
56 NPRM para. 433.
57 *See* NPRM para. 434.

leaning expressed in the NPRM to develop a "total cost" model that would predict the forward-looking economic cost of deploying a complete network capable of providing broadband and voice services at levels that meet regulatory requirements.[58] Given that the Commission expects all CAF recipients to replace their circuit-switched networks with IP-based networks, it makes no sense to size the amount of CAF available for a given area assuming an existing network which likely is incapable of delivering broadband service to unserved households.

FairPoint also agrees that it would be premature to attempt including revenue predictions in this model.[59] Estimating revenues from a service that is not yet available to customers would be highly speculative. Even current demand data are quite recent, and limited to densely populated markets, so as to be of very limited value in estimating demand in sparsely populated areas.

Finally, FairPoint agrees that the model must take into account local cost variations. The model should reflect not only the engineering factors cited in the NPRM, such as soil type, availability of aerial or buried plant, locations of homes and roads, but also other factors affecting the cost to deploy broadband, including labor costs, and legal issues such as necessary state or local regulatory hurdles for access to rights of way.[60] FairPoint believes that the most efficient way to target an adequate amount of support where it is most needed is to identify with as much particularity as possible the local costs and barriers to broadband deployment at a granular level, even down to the wire center footprint.

The application of the Commission's current non-rural high-cost proxy model ("HCPM") funding in FairPoint's Northern New England operations is illustrative. Based on national cost

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[58] NPRM para. 438.
[59] NPRM para. 439.
[60] NPRM para. 443.

inputs from the largest carriers at the time, the FCC constructed the HCPM to provide "rough justice" in calculating the support that should flow to different states where costs generally are much higher than the national average. However, FairPoint submits that the HCPM operates in an arbitrary manner and has produced insufficient funding to high-cost areas in the state of New Hampshire. New Hampshire receives no HCPM funding at all. Although the costs of serving very rural and mountainous northern areas of the state are relatively high, the model produces zero support for the state because it averages those costs with the costs associated with serving much more densely-populated southern New Hampshire. FairPoint suggests that a better-designed model can address such discrepancies in funding high-cost areas.

B. FairPoint Supports the Long-Term Goal Of Transitioning To Incentive-Based Regulation Where It Makes Economic Sense

FCC policies have encouraged but not required all local exchange carriers to move from cost-based rate-of-return regulation to price cap regulation. FairPoint has experience converting small, rural ILECs from rate-of-return to price cap regulation, as well as experience operating mandatory price cap ILECs (purchased from a Bell Operating Company).

While incentive-based regulation can confer some long-term benefits, it is not without its risks and can be disruptive in the short term. Improvements in cost control must be balanced with preservation and enhancement of service quality, reliability, availability and affordability. FairPoint appreciates that the NPRM takes a measured approach, suggesting that the Commission wait until its proposed Phase I reforms are enacted and take effect before attempting more potentially disruptive and risky changes. As the NPRM notes, the Commission may find that its early reforms sufficiently address any concerns about inefficiency and investment incentives, such that small, rural ILECs may then reasonably remain in a cost-based regulatory framework, albeit with improved efficiencies and controls.[61]

Certainly, as the FCC has recognized over the years, a certain scale of operations is necessary to justify departure from the NECA traffic-sensitive pool, development of price cap tariffs, and compliance with the myriad regulations that are unique to price cap carriers. Not only are price cap carriers subject to increased regulatory burdens on the whole, but they also have very limited recourse should they fail to earn a reasonable return on investment. For some carriers, these trade-offs are justified by the increased pricing flexibility enjoyed under price cap regulation. But it is a choice that depends on many considerations.

FairPoint therefore supports the proposal not to decide at this junction whether to accelerate the transition of all remaining rate-of-return carriers to price caps but instead to evaluate the merits of such a proposal after the Phase I reforms discussed in the NPRM have been realized.

V. CONCLUSION

The U.S. telecommunications infrastructure effectively enables high-quality, reliable voice service to all Americans today because of decades of consistent investment and public policies that prioritized universal coverage. There are not sufficient economic incentives for existing network providers to build broadband infrastructure to all high-cost and remote areas absent continued public funding commitment. FairPoint believes that the CAF as currently conceived by the Commission will be woefully inadequate to achieve the FCC's stated goals. The Commission (or Congress) should provide for a significant increase in funding to maintain and upgrade public networks, and ensure that federal rules and policies are crafted to carefully

61 NPRM para. 448.

direct the funding to the providers that are committed by law to providing service to every household in their territories, the "carriers of last resort" for the digital age.

Respectfully submitted,

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